

**CITY OF RIVERSIDE
PUBLIC UTILITIES**

POWER RESOURCES RISK MANAGEMENT POLICIES

ENERGY RISK MANAGEMENT POLICY

**WHOLESALE COUNTERPARTY RISK MANAGEMENT
POLICY**

AUTHORIZED TRANSACTIONS POLICY

GLOSSARY

CITY COUNCIL MEMORANDUM

March 5, 2013
Amended April 29, 2014

**CITY COUNCIL RESOLUTION APPROVING CURRENT
POLICIES AND PROCEDURES**

CITY OF RIVERSIDE PUBLIC UTILITIES

POWER RESOURCES RISK MANAGEMENT POLICIES

ENERGY RISK MANAGEMENT POLICY

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CITY OF RIVERSIDE PUBLIC UTILITIES

ENERGY RISK MANAGEMENT POLICY

1. Introduction

As a municipal utility, the City of Riverside's Public Utilities Department ("RPU") is in the business of generating, transmitting and distributing electricity for the benefit of its citizen-ratepayers. RPU's objective is to minimize the overall cost of providing this service by developing, optimizing and maintaining a best available price supply portfolio that maximizes the value of its physical and financial wholesale power Transactions while minimizing the attendant financial risks. However, unlike a private-sector entity, RPU is not currently engaged in the power supply business strictly for profit. As a result, RPU is defined as a cost hedger and, therefore, precluded by this Policy from engaging in many of the risk-taking activities typical to an organization orientated solely toward profit maximization.

2. Risk Management Objectives

Although RPU does not engage in risk-taking activities typical to a private-sector organization, management recognizes that certain risks are incidental to normal power supply operations and Hedging activities. RPU's Policy is to manage risk inherent with serving load, including the risks associated with normal cost-hedging activities, those associated with participation in wholesale markets in general and the California Independent System Operator ("CAISO") in particular. This document serves as a vehicle to describe and define the Risk Management activities considered appropriate for RPU in the normal course of business.

RPU's supply portfolio is exposed to several risks, including but not limited to: (i) load variability; (ii) cost variability (including applicable CAISO resource sufficiency and associated price caps, congestion costs, energy costs and energy losses); (iii) Counterparty Risk; (iv) energy commodity price volatility; and (v) regulatory/legislative risk. From the perspective of risk mitigation, RPU's primary objective is to manage the cost of serving its customers. Normal power supply activities are to be focused around this objective. Taking unnecessary risk in order to arbitrage market opportunities, or risks unrelated to RPU's normal power supply business activities, is considered inappropriate.

RPU Power Resources management will manage Business Risks to acceptable levels established by the Risk Management Committee ("RMC"), as reviewed by the Public Utilities Board and approved by the City Council pursuant to Section 3 of this Policy.

RPU shall ensure that the use of its fuel, power resources and its transmission systems are reliable over the long-term and designed to minimize the effects of interruption or curtailment. RPU Power Resources may not engage in activities that expose the City of Riverside to speculative commodity trading risks. The Energy Risk Management Policy prescribes Transaction parameters and maximum acceptable risk limits as presented in Attachments 3 and 4 of this Policy.

To the extent feasible, given various political, regulatory and environmental constraints, RPU shall ensure that the costs of its fuels, power resources and related transmission systems remain competitive over the long-term. Therefore, RPU shall conduct its fuels, power procurements and other Transaction Activities in a manner necessary to compete successfully in the marketplace as a cost hedger. Fuel procurement activities will be conducted under the same Risk Management principles and procedures as power supply.

RPU Power Resources employees shall maintain the confidentiality of strategic plans for competitive Transactions and information exchanged with partners, suppliers, customers and other entities as necessary for successful market participation, to the fullest extent allowed under California's Public Records Act requirements.

RPU employees involved with Energy Risk Management activities, including the Risk Management Committee members (refer to Attachment 1 of this Policy), Utilities Power Resources Managers and RPU operational level employees are expected to understand fully the extent to which their decisions and actions expose RPU to risk. Any activities that are not related to RPU's normal power supply business or have the effect, or potential of increasing risk without authorization, shall be avoided. The Energy Risk Manager shall be responsible for ensuring all Power Resources employees executing Transactions reads and understands the Power Resources Risk Management Policies and signifies in writing that they have done so by completing the Energy Risk Management Policy Acknowledgement Form – Attachment 2 of this Policy. The Energy Risk Manager shall retain these forms.

3. Risk Governance Structure and Responsibilities

a. City Council:

- i. Approval of substantive modifications and amendments to the Power Resources Risk Management Policies.
- ii. Ultimate authority for all Transactions entered into pursuant to the Power Resources Risk Management Policies, notwithstanding any delegations specified in the Policy.
- iii. Approval of bilateral agreements for a term longer than five (5) calendar years or sixty (60) months.

b. Public Utilities Board:

- i. Transaction approval authorities within the limits established in the Power Resources Transaction Limits Summaries for Energy and Natural Gas, Attachments 3 and 4 of this Policy.
- ii. Conduct Public Utilities Board or Customer Relations/Finance Committee meetings as needed, to review the Risk Management process including, but not limited to, risk control methodologies, product types, and performance.
- iii. Review and recommend City Council approval of substantive modifications and amendments to the Power Resources Risk Management Policies.

c. Risk Management Committee:

The RMC serves as the highest level of organizational Risk Management reporting to the Public Utilities Board and City Council. The RMC shall consist of the members listed in Attachment 1. The RMC is responsible for approving procedures to ensure compliance with Power Resources Risk Management Policies within RPU Power Resources.

As delegated by the Public Utilities Board and the City Council, responsibilities and authorities of the RMC include:

- i. Transaction approval authorities within the limits established in the Power Resources Transaction Limits Summaries for Energy and Natural Gas,

Attachments 3 and 4 of this Policy.

- ii. Approving the use of all types of forward and Optimization Strategies proposed by the RPU Power Resources group prior to the consummation of individual Transactions (including the historical practices and any deviation from historical practices).
- iii. Approving all financial limits associated with Transactions within the authorization as described in this Policy.
- iv. Approving the use of financial instruments on a case-by-case basis.
- v. Approving all long-term power supply strategies. Approval authority for long-term strategic plans and modeling parameters is not limited by fiscal constraints however; such plans shall be subject to review and approval by the Public Utilities Board.
- vi. Approval of strategy adjustments that result in variations of approved Transactions.
- vii. Approval of enterprise unit strategies, and associated types of transactions (not individual Transactions), expected to facilitate RPU's compliance with all relevant power procurement reliability standards and reserve requirements.
- viii. Approval of New Products as specified in Section 8 of the Authorized Transactions Policy.
- ix. Reviewing and assessing the adequacy of risk reports generated by the Middle-Office.
- x. Periodic review and approval of counterparty credit lines. Subsequent actions can result in approval, rejection or amendment to credit limits approved under delegated approval authorities.
- xi. Authority to waive credit standards on a case-by-case basis to comply with regulatory or governmental mandates.
- xii. Authority to waive credit standards on a case-by-case basis for RPU term purchase Transactions to limit price volatility risk.
- xiii. Assessing the adequacy and functioning of the system of controls for effectively implementing the Power Resources Risk Management Policies.
- xiv. Setting, changing and approving the design of internal control processes related to power supply.
- xv. Recommending capital allocation consistent with performance objectives and the overall strategic direction of RPU.
- xvi. Recommending adequate staffing and resources (e.g., number, level and experience of staff, compensation policy, hardware and software support, etc.) for RPU Power Resources.
- xvii. Recommending the structure of compensation to ensure it does not create incentives that conflict with maintaining the integrity of the risk control

infrastructure.

- xviii. Ensuring that adequate capital reserves are maintained for credit, operations and liquidity.
- xix. Recommending, as necessary, that the Public Utilities Board and City Council approve any substantive modifications or amendments to the Power Resources Risk Management Policies and associated Policies identified in Section 13 in the manner described above.

The RMC will conduct meetings as needed, but at least quarterly, to review and, if necessary, act upon the duties and responsibilities mentioned above. RMC meetings may be conducted with at least three members of the committee one of whom must be the Utilities General Manager. Any action must be affirmatively approved by the RMC prior to such action becoming effective. If the Utilities General Manager is absent or votes “no”, then no action shall be taken or become effective. Meetings may be conducted in-person, telephonically, electronically, or by any comparable means by which proposed actions may be described, discussed, and approved.

d. RPU Administration:

RPU Administration is responsible for implementing the risk control structure, including the segregation of duties and independent organizational oversight. RPU Administration is identified as the Public Utilities General Manager, Utilities Assistant General Manager-Finance, and the Utilities Assistant General Manager-Resources. Pursuant to the Riverside City Charter sections 407, 601 and 1200, RPU Administration, with the approval of the City Manager, has the authority to assign particular employees to particular duties or job functions within the organization, and to fill any job vacancies on an interim basis pending permanent appointments.

RPU Administration may delegate risk-monitoring responsibilities within the Middle-Office (i.e., Energy Risk Management) function. The delegation of these responsibilities does not diminish the responsibilities of RPU Administration or Utilities Power Resources Managers, nor does it mitigate the necessity for an independent Risk Management oversight function.

As delegated by the Public Utilities Board and the City Council, responsibilities and authorities of the Public Utilities General Manager, the Utilities Assistant General Manager-Finance and/or the Utilities Assistant General Manager-Resources include:

- i. Transaction approval authorities within the limits established in the Power Resources Transaction Limits Summary for Energy and Natural Gas, Attachments 3 and 4 of this Policy.
- ii. Review and approval of the Transaction strategy by the Utilities Assistant General Manager-Resources.
- iii. Approval authorities within the limits established in Section 3 of the Wholesale Counterparty Risk Management Policy.
- iv. Counterparty prepayment authorization (refer to Section 5 of the Wholesale Counterparty Risk Management Policy).

- v. Authority to approve any non-substantive modifications or amendments to the Power Resources Risk Management Policies and associated Policies identified in Section 13 with concurrence with the City Attorney's Office.

4. Operational Management Oversight – Front-, Middle-, Back-Office

Utilities Power Resources Managers have the responsibility for Front- and Back-Office activities. The Utilities Power Resources Managers report to the Utilities Assistant General Manager-Resources and are responsible for developing and implementing market strategies and gaining approval for and transacting in new products/markets consistent with goals outlined in this Policy.

Position title changes approved by the City Council shall not have any effect upon the delegations of authority and responsibilities as described in this Policy and associated Policies identified in Section 13. Any position title changes shall be updated in the regular Policy review and approval process by the Public Utilities Board and City Council as described above.

In executing Power Resources activities, Utilities Power Resources Managers may seek the advice and involvement of individuals outside the business unit for issues related to areas outside the unit's expertise.

Utilities Power Resources Managers may approve confirmations or special conditions (pursuant to an approved master or enabling agreement.) However, confirmations that contain modifications to the legal terms and conditions must be reviewed by the City Attorney's Office and then approved by the Utilities Power Resources Management. Substantive modifications will also need to be approved by the Public Utilities Board and City Council.

The Energy Risk Manager has the responsibility for Middle-Office and is responsible for ensuring the effectiveness of the control structure, risk measurement and monthly management reporting. This includes measuring, assessing and reporting all inherent risk profiles including market, liquidity and credit risks such as counterparty exposures, Transaction limits, etc. The Energy Risk Manager shall meet with the Utilities Power Resources Managers as needed.

Each function has special concerns and responsibilities in the Transaction Activities. For purposes of risk mitigation, the RMC is authorized to approve enterprise unit strategies, and associated types of transactions (not individual Transactions), expected to facilitate RPU's compliance related to pertinent planning reliability standards and reserve requirements ("Supply Requirements") mandated by (i) the City Council, (ii) the CAISO, and (iii) the requirements of regulatory agencies of competent jurisdiction.

a. Front-Office

The Front-Office is comprised of those functions related to the business activities of RPU Power Resources. The Utilities Power Resources Managers are directly involved in resource planning, product procurement and sales Transactions and implementation of strategies within authorized limits. Position titles of specific Utilities Power Resources Managers or other employees may not be identical to the following job functions.

Term Trading

Term Trading encompasses those functions associated with monthly, quarterly, annual and long term planning. As a result, this function constitutes the fiscal

planning arm of the resource procurement process.

Long-Term Contracts

Long-term contract terms are generally greater than five years and must be approved by the Public Utilities Board and the City Council. RPU may enter into a power purchase agreement to buy energy (with or without environmental attributes), natural gas, capacity, transmission and/or ancillary services to manage the supply portfolio with cost certainty. Long-term contract Transaction activities, processes and reporting are typically exempt from the requirements of Power Resources Risk Management Policies.

Market Operations/Trading`

Market Operations/Trading is responsible for day ahead and real-time trading activities.

Day Ahead Trading

The day ahead trading function is responsible for executing Transactions according to their most recent load forecast and load/resource balance.

Day ahead trading is delegated authority for individual Transactions as identified in Attachments 1 and 2 of the Authorized Transactions Policy and within the limits established in the Power Resources Transaction Limits Summaries for Energy and Natural Gas, Attachments 3 and 4 of this Policy. This activity requires constant monitoring of the load/resource balance and the ability to determine the appropriate Transactions necessary to maintain the load/resource balance and implement resource Optimization Strategies.

Real-Time Trading

In “real time,” or within the day, the principal concern is to serve the hourly loads. Since this activity entails hourly adjustments of the load/resource balance, volume constraints are not dictated by this Policy. Real-Time Trading is delegated the authority for individual Transactions as identified in Attachments 1 and 2 of the Authorized Transaction Policy and within the limits established in the Power Resources Transaction Limits Summaries for Energy and Natural Gas, Attachments 3 and 4 of this Policy.

Front-Office activities and delegated authorities include:

- i. Primary interface with all wholesale counterparties, including but not limited to, independent power producers, investor-owned utilities, broker/dealer organizations and governmental organizations.
- ii. Transact with counterparties on the Approved Counterparty list.
- iii. Identifying and recommending counterparty candidates to the Middle-Office for review and approval.
- iv. Optimize the economics of resources through physical and financial purchase and sale Transactions consistent with this Policy.

- v. Enter into natural gas Transactions, including transportation, storage and purchases to cover monthly, quarterly and annual supply requirements as contained in the RMC approved Forward Strategy Sheet.
 - vi. Enter into electric capacity transactions to meet capacity requirements.
 - vii. Enter into emissions Transactions to meet regulatory requirements.
 - viii. Ensure proper legal authority exists to transact with counterparties.
 - ix. Establishing bi-lateral transaction structures, strategies, pricing, positioning and Hedging within authorized limits and pursuant to existing contractual arrangements.
 - x. Developing and establishing functional procedures to ensure workflow transparency and cross-training among line personnel.
 - xi. Transaction approval limits are established in the Power Resources Transaction Limits Summaries for Energy and Natural Gas, Attachments 3 and 4 of this Policy.
 - xii. Engage in individual Transactions with terms that are hourly through the following business day.
- b. Middle-Office

The Middle-Office is comprised of those functions related to Risk Management and counterparty credit. Middle-Office activities are the primary responsibility of the Energy Risk Manager as delegated by the RMC.

The Energy Risk Manager may report directly to the Public Utilities General Manager or to an individual at the Assistant General Manager level which does not oversee daily power operations. The Energy Risk Manager will be functionally and organizationally independent from all business activities. As a result, the Energy Risk Manager's primary responsibilities are to manage the Middle-Office function, develop and propose to the RMC changes to this Policy and otherwise ensure that all products utilized and Transaction Activities are undertaken in compliance with current policy. This arrangement will provide independent and regular management oversight for all Hedging and Transacting Activities. The role of the Energy Risk Management function is review and oversight and will not include daily Front-Office or Back-Office business activities.

The Energy Risk Manager will be responsible for the wholesale counterparty credit review process and will serve as the first level of approval for all counterparty credit limit determinations. The Energy Risk Manager, along with the Utilities Power Resources Managers, are responsible for monitoring counterparty credit risk and shall notify RPU Power Resources in the event the counterparty's credit risk profile has changed and thus warrants a corresponding change in the counterparty Transaction limit. Additional discussion is in Section 6 of the Wholesale Counterparty Risk Management Policy.

In the event of an actual or potential violation of the Power Resources Risk Management Policies, such actual or potential violations should be brought to the attention of the Energy Risk Manager. The Energy Risk Manager shall investigate and document the circumstances surrounding the alleged violation. A report of the actual or potential violation may be provided to the Risk Management Committee at the recommendation of the Energy Risk Manager after consultation with the City Attorney's Office.

Middle-Office activities and delegated authorities include:

- i. Monitoring and assessing current and potential risk exposures.
 - ii. Transaction compliance with this Policy.
 - iii. Preparing, verifying and distributing all Risk Management reports.
 - iv. Ensuring credit enhancements used by counterparties as a basis for transacting remain current.
 - v. Temporarily or permanently halting Transactions with an otherwise approved counterparty because of credit exposure or credit condition.
 - vi. Convening the RMC and obtaining approvals for revisions to this Policy or associated Policies.
 - vii. Monitoring and assessing the Policies identified in Section 13, Associated Guidelines, Controls, Policies and Procedures.
 - viii. Transaction approval authorities within the limits established in the Power Resources Transaction Limits Summaries for Energy and Natural Gas, Attachments 3 and 4 of this Policy.
 - ix. Approval authorities within the limits established in Section 3 of the Wholesale Counterparty Risk Management Policy.
 - x. Authority to add a new counterparty to the Approved Counterparty list with a credit limit not to exceed the approval authority as delegated in this Section 3 of the Wholesale Counterparty Risk Management Policy.
 - xi. Authority to decrease or increase counterparty's authorized credit limit not to exceed the amount established pursuant to Section 3 of the Wholesale Counterparty Risk Management Policy.
 - xii. Responsible for reporting the addition of new counterparties under the authority of the Energy Risk Manager and all credit limit changes with justification to the RMC.
- c. Back-Office

The Back-Office is comprised of those functions responsible for verification, validation accounting, processing, reconciling and settling all Transactions. The responsibilities of the Back-Office encompass comprehensive support of all Transactional Activities.

Power Contracts/Projects encompass those contractual and settlement functions associated with charges related to contractual ownership or entitlements, as well as the validation, verification, and reconciliation of Transactions conducted by the Planning and Market Operations/Trading.

Back-Office activities and delegated authorities include:

- i. Ensuring proper verification, validation, reconciliation, analysis and reporting of RPU Power Resources Transactions.

- ii. Assuring completeness in data gathering and transaction reporting, counterparty confirmations, data integrity and workflow transparency between Front- and Back-Office activities.
- iii. Confirmation of Transactions.
- iv. Tracking, processing, supporting, reporting, and/or performing Transaction settlements.
- v. Contract management and compliance.
- vi. Interfacing with RPU Finance division to ensure proper energy and natural gas accounting and provide assistance with financial accounting and payment processing.
- vii. Review, negotiate and seek internal approvals (Public Utilities Board and/or City Council) of applicable enabling agreements to facilitate Transacting with counterparties.
- viii. Administer the terms and conditions of applicable agreements.
- ix. Review Transaction confirmation agreements to ascertain conformance with the terms and conditions of the underlying enabling agreement and business Transactions and report deviations to Front-Office.
- x. Ascertain that fully executed Transaction confirmation agreements are in place before Transactions take place (or in rare circumstances unexecuted confirmations supported by voice recordings in conformance with the enabling agreement).
- xi. Catalogue and safeguard copies of agreements and Transaction confirmation agreements.
- xii. Review, validate, verify, reconcile, and resolve discrepancies regarding charges from and billings to counterparties.
- xiii. Provide periodic Transaction settlement reports for financial tracking and planning purposes.

5. Segregation of Duties

Appropriate segregation of duties is to be established and maintained throughout the system of controls over financial risks. Senior management must be diligent in ensuring that appropriate segregation of duties is adhered to within the context of organizational changes, while considering staffing limitations, RPU's business model as a cost hedger, and the overall level of transactions with counterparties.

Controls over inputs and systems operations are of particular importance in ensuring the integrity of data used in risk control and management. In all cases, there will be an appropriate segregation of duties or oversight to reduce the risk of error and/or fraud.

To the maximum extent practicable given RPU's business model and level of staffing, Front-Office activities will be functionally independent from Middle- and Back-Office activities. As a result, the

Front-Office will generally neither perform nor supervise Middle-Office Risk Management activities, or Back-Office financial accounting or settlements. One exception is the Power Contracts/Projects function which also supervises Back-Office activities, and is involved in the negotiation and administration of power contracts/projects, but not the typical execution of either Term, Day Ahead or Real-Time trading activities. This does not reduce the Front-Office personnel and Utilities Power Resources Managers' responsibility for accurately recording, valuing and considering the risk associated with their activities. Utilities Power Resources Managers are responsible for ensuring the Front-Office's ability to perform delegated tasks in compliance with this Policy. This arrangement will provide independent and regular management oversight for both risk-taking and risk-control activities. It will also allow for a clear separation of duties between the Front-Office transacting and Middle-Office risk-control functions.

To the maximum extent practicable given RPU's business model and level of staffing, Middle-Office activities will be functionally independent from all Front-Office and Back-Office activities. The Middle-Office will have primary responsibility for Risk Management oversight and policy development and compliance. If there are not adequate resources necessary to fully support a Middle-Office, this function may be combined with another function provided that appropriate segregation of duties or sufficient internal controls are maintained at all times.

To the maximum extent practicable given RPU's business model and level of staffing, Back-Office settlement activities will be functionally independent from all Front-Office and Middle-Office activities. The Back-Office will have primary responsibility for all Transaction confirmation, accounting and reconciliation processes. If there are not adequate resources necessary to fully support a Back-Office, this function may be combined with another function provided that appropriate segregation of duties or sufficient internal controls are maintained at all times.

6. City Attorney's Office

A designated member of the City Attorney's Office shall serve as legal counsel to the RMC and shall advise staff, the RMC, the Public Utilities Board, and the City Council on all legal issues related to this Energy Risk Management Policy and the Policies identified in Section 13, Associated Guidelines, Controls, Policies and Procedures.

7. Risk Measurement, Monitoring, Reporting

Key to energy risk management is the monitoring of risks and the accurate and timely information that must be provided to all parties involved in any aspects of energy risk management to allow them to perform their functions appropriately. Periodic reports (e.g. monthly, quarterly, yearly) will be provided to the RMC and other appropriate parties which provide details on Transactions as determined by the RMC.

8. Hedging Program

RPU seeks to minimize financial exposure to higher-volatility spot market wholesale electricity and natural gas prices by the use of rolling hedges and open position percentage bands as approved by the Forward Strategy Sheet. Financial exposure creates budget uncertainty. In order to mitigate the financial exposure to short time horizon price volatility, RPU continually reduces its financial exposure by reducing the quantity of energy in either open long or short positions. Prompt and nearby months are hedged as close to 100% as possible, unless otherwise approved by the RMC. Since commodity price volatility is greater in the short time horizon and because there is more delivery certainty with respect to RPU's assets and supply contracts, prompt or nearby fiscal years are more fully hedged than outer years. This Hedging philosophy provides more budget certainty for the current and nearby fiscal years.

Since the open position percentage bands drive ever decreasing open position levels over time, as a month approaches operational delivery, RPU will already have a large percentage of the requirements purchased if short or sold if long to comply with policy. Therefore, there should only be a small percentage of energy left to buy or sell just prior to a given delivery month.

Regardless of the Hedging strategy, RPU would still have some exposure to spot market prices due to the quantity mismatch between block energy purchases and sales and the energy consumption pattern of RPU's retail customer base. While a block purchase may be used to reduce overall financial exposure, RPU may be exposed to potentially having purchased too much energy to meet peak loads and selling the excess during shoulder or off-peak periods when loads and prices are lower.

Analyses of the most cost effective combination of Options, forward contracts and fixed price purchases are conducted regularly by the Planning function. The results of these analyses are presented to the Risk Management Committee regularly in a Forward Strategy Sheet where the Hedging program is reviewed and approved.

9. Derivatives for Financial Transactions

Use of Derivatives should be consistent with the overall business and Risk Management objectives of RPU as a cost hedger. Derivatives may be used to manage Business Risk within limits specified by this Policy to manage financial exposures that have been identified through the risk identification and measurement process, provided that they qualify clearly as "Hedging" activities as defined in this Policy. Derivative risk should be evaluated against the exposure it is expected to modify. From this perspective, Derivatives should not increase net exposure to market risk, since the market risk created by use of the Derivatives should be offset by exposures they modify (e.g., financial Swap for price certainty).

The use of Derivatives should be assessed against any additional risk, and such use is permitted only to the extent that the expected benefit is considered to outweigh these risks. All strategies are to be reviewed against the fiscal budget to ensure proper financial planning and control. Net incremental risk exposure created from the use of Derivatives is inconsistent with RPU Risk Management objectives described in this Policy and the associated Policies identified in Section 13.

Selling or "writing" financial Options (i.e., where RPU is obligated to perform) is not permitted unless used for Hedging-purposes only (i.e., to create a fence or collar for budget purposes, selling an Option against a long position, etc.).

10. Waivers

As described in Section 3 above, the RMC has the authority to waive (i) credit standards on a case-by-case basis to comply with regulatory or governmental mandates and, (ii) credit standards on a case-by-case basis for RPU term purchase Transactions to limit price volatility risk.

11. Conflict of Interest

RPU employees or officers responsible for directly supporting, reviewing or authorizing Transaction Activities shall not enter into, or direct others to enter into, any energy, natural gas, or related Transactions other than on behalf of RPU, the City of Riverside, entities under a valid Utilities Service Agreement with the City or the City's authorized agents. Notwithstanding the preceding sentence, designated RPU staff may perform Front-Office and Back-Office activities on the behalf of others with whom the City of Riverside has contractually agreed to provide such services. All appropriate RPU employees and officers will be required to file an annual Statement of Economic Interests in order to disclose any financial interest in RPU counterparties.

12. Authorization Notification

As personnel changes dictate, the Public Utilities General Manager, or his respective designee, will inform counterparties and brokers regarding those personnel who are authorized to perform Front-, Middle- and Back-Office activities on behalf of RPU. The RMC and Public Utilities General Manager, or their respective designees, are authorized to inform counterparties of any other authorizing restrictions (i.e., no leveraged Transactions, etc.) imposed on such authorized personnel. Additionally, the Utilities Power Resources Managers or the RMC members may, for the avoidance of doubt, inform counterparties regarding trading authority and restrictions, including authorized product types and/or term limits.

13. Associated Guidelines, Controls, Policies and Procedures

The required supporting policies and procedures to this Policy are outlined below. Approval and modification of such supporting policies and procedures requires the approval of the Public Utilities Board and City Council unless otherwise stated.

City of Riverside Public Utilities Wholesale Counterparty Risk Management Policy

City of Riverside Public Utilities Authorized Transactions Policy

City Council Resolution Approving Current Policies and Procedures

ATTACHMENT 1

Risk Management Committee ("RMC") Membership List

Public Utilities General Manager (Chair)

Utilities Assistant General Manager-Finance

Utilities Assistant General Manager-Resources

Energy Risk Manager (Secretary)

The RMC will be chaired by the Public Utilities General Manager. The Energy Risk Manager will act as secretary. Meetings may be conducted with a quorum of three RMC members, one of whom must be the Utilities General Manager. Agenda items requiring RMC action must be approved by a minimum of at least three (3) members, including the Public Utilities General Manager prior to becoming effective (refer to Section 3 of this Policy.)

A designated member of the City Attorney's Office shall serve as legal counsel to the RMC and shall advise staff, the RMC, the Public Utilities Board, and the City Council on all legal issues related to the Energy Risk Management Policy and associated Policies identified above in Section 13 (refer to Section 6 of this Policy.)

ATTACHMENT 2

Energy Risk Management Policy Acknowledgement Form

The purpose of this form is for the individual RPU employee involved with Energy Risk Management activities, including but not limited to, Front-, Middle- or Back-Office activities associated with Transactions, trading, Risk Management and other related activities to acknowledge that they have received, read and understood the Energy Risk Management Policy and related Policies adopted by RPU.

The employee recognizes that violating the Energy Risk Management Policy and related Policies can lead to disciplinary actions or even termination.

Employee Name _____

Title _____

Department _____

Supervisor _____

Control Office ☐ Front-Office
 ☐ Middle-Office
 ☐ Back-Office
 ☐ Other

This form acknowledges that I have received, read and understood the Energy Risk Management Policy and related Policies as described in Section 13 of this Policy.

Signature of Employee

Signature of Energy Risk Manager

Date

Employee shall not transact business until the employee name is added to the authorized traders list and this form is signed by the Energy Risk Manager.

This form shall be sent to Riverside Public Utilities Energy Risk Manager.

ATTACHMENT 3
POWER RESOURCES ENERGY TRANSACTION LIMITS SUMMARY

EXECUTION AUTHORITY	PUBLIC UTILITIES BOARD	RISK MANAGEMENT COMMITTEE	PUBLIC UTILITIES GENERAL MANAGER and ASSISTANT GENERAL MANAGER(S)	TERM TRADING	DAY AHEAD TRADING	REAL-TIME TRADING
TERM LIMITS	Not to exceed 5 calendar years.	Transaction terms up to 48 consecutive months not to exceed Forward Strategy Sheet (FSS) approval.	Transaction terms up to 36 consecutive months not to exceed Forward Strategy Sheet (FSS) approval.	Transaction terms up to 24 consecutive months not to exceed Forward Strategy Sheet (FSS) approval.	Day ahead to balance of the current month. Prompt month beginning 10 days prior to conclusion of the current month.	Hourly through the following business day.
VOLUME LIMITS Capacity Energy Transmission CRRs OATT Ancillary Services	Up to 115% of annual peak forecast. Hedge and resource planning strategy parameters. Delegations of authority to enterprise unit.		Capacity requirements: Up to but not greater than 115% of annual peak load forecast Energy requirements: Up to native load, plus contract obligations			Hourly supply requirements up to 115% of hourly peak load forecast. Transacting limited to variability between supply requirements and contracted resources.
FINANCIAL LIMITS	Not applicable	Up to 100% above the forecast energy price projection in the FSS.	PUGM: Up to 50% above the forecast energy price projection in the FSS. AGMs: Up to 25% above the forecast energy price projection in the FSS.	Up to 100% forecast energy price in the FSS.	Financial limits not applicable. Day Ahead and Real-Time trading is oriented to physical needs and financial risks should be minimized prior to reaching real-time activity.	
OPTIMIZATION	Approval of changes to the Policies.	Approval of changes or additions to authorized transactions.	Volume limits not applicable. Document and report net reduction of power supply cost or reduction of other risks.		Volume limits not applicable for the purpose of net reduction of power supply cost or reduction of other risks.	
COUNTERPARTY CREDIT LIMITS	Up to \$20,000,000		PUGM: Up to \$15,000,000 AGMs: Up to \$10,000,000 Energy Risk Manager: Up to \$5,000,000	Intentionally left blank.		

ATTACHMENT 4
POWER RESOURCES NATURAL GAS TRANSACTION LIMITS SUMMARY

EXECUTION AUTHORITY	PUBLIC UTILITIES BOARD	RISK MANAGEMENT COMMITTEE	PUBLIC UTILITIES GENERAL MANAGER and ASSISTANT GENERAL MANAGER(S)	TERM TRADING	DAY AHEAD TRADING	REAL-TIME TRADING
TERM LIMITS	Not to exceed 5 calendar years.	Transaction terms up to 48 consecutive months not to exceed Forward Strategy Sheet (FSS) approval.	Transaction terms up to 36 consecutive months not to exceed Forward Strategy Sheet (FSS) approval.	Transaction terms up to 24 consecutive months not to exceed Forward Strategy Sheet (FSS) approval.	Day ahead to balance of the current month. Prompt month beginning 10 days prior to conclusion of the current month.	Hourly through the following business day.
VOLUME LIMITS	Not to exceed uncovered projected requirements.					
FINANCIAL LIMITS	Not applicable	Up to 100% above the forecast energy price projection in the FSS.	PUGM: Up to 50% above the forecast gas price projection in the FSS. AGMs: Up to 25% above the forecast gas price projection in the FSS.	Up to 100% forecast gas price in the FSS.	Financial limits not applicable. Day Ahead and Real-Time trading is oriented to physical needs and financial risks should be minimized prior to reaching real-time activity.	
OPTIMIZATION	Approval of changes to the Policies.	Approval of changes or additions to authorized transactions.	Volume limits not applicable. Document and report net reduction of power supply cost or reduction of other risks.		Volume limits not applicable for the purpose of net reduction of power supply cost or reduction of other risks.	
COUNTERPARTY CREDIT LIMITS	Up to \$20,000,000		PUGM: Up to \$15,000,000 AGMs: Up to \$10,000,000 Energy Risk Manager: Up to \$5,000,000	Intentionally left blank.		

CITY OF RIVERSIDE PUBLIC UTILITIES

POWER RESOURCES RISK MANAGEMENT POLICIES

WHOLESALE COUNTERPARTY RISK MANAGEMENT POLICY

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For California Wholesale Electric Markets

CITY OF RIVERSIDE PUBLIC UTILITIES

WHOLESALE COUNTERPARTY RISK MANAGEMENT POLICY

1. Introduction

The City of Riverside Public Utilities' ("RPU") electric power supply activities are directed toward the goal of providing electricity to its retail customers at the best available price consistent with sound business practices, while maintaining the reliability of the electric system. Effective wholesale counterparty management and credit analysis is essential to mitigate the counterparty credit risk associated with physical or financial Transactions in electricity markets. The objective of the Wholesale Counterparty Risk Management Policy is to preserve RPU's capital, liquidity and supply reliability by limiting wholesale counterparty credit risk to acceptable levels.

Analytical procedures for granting open lines of credit and managing counterparty exposures are required. However, RPU recognizes that the models used in managing credit risk are not predictive; they are explanatory. Credit risk management models cannot predict individual or collective credit events. Wholesale Counterparty Risk Management is expected to manage counterparty credit risks to acceptable levels established by the Risk Management Committee ("RMC"). In general, City management recognizes that RPU is currently a net buyer of resources. Therefore, exposure to counterparty credit risk will normally be greater in periods of rising market prices. Retail customer activity is currently excluded from these Policy requirements.

RPU fulfills its supply obligations by purchasing or selling power supply-related commodities that it owns or controls, contracting with counterparties on a long-term or short-term basis, or participating in the markets administered by the California Independent System Operator ("CAISO"). RPU is exposed to various risks through its participation in the CAISO Markets. Attachment 5 of this Policy describes RPU's internal assessment of the various risks that RPU is exposed to in its participation in the organized wholesale electric market and its Congestion Revenue Rights allocation and auction activities with the CAISO.

2. Counterparty Credit Risk

Forms of Counterparty credit risk are:

Payment Risk – the potential loss from the failure of a counterparty to make payment on a contract.

Performance Risk – the potential loss from the failure of a counterparty to deliver or take delivery on a contract.

Counterparty credit risk may be monitored by the Energy Risk Manager, with recommendations to the RMC as necessary, according to the concentration in the following areas: credit rating, region, contract type, contract term and Mark-to-Market exposure.

3. Approval Authority

Approval authorities are based on the expected notional dollar quantity associated with Transactions to cover RPU's Transaction Activities. The notional dollar quantity shall be reviewed annually or more frequently as required and adjusted based on market prices and open exposure volumes. Authority to establish counterparty credit limits is segregated as described in Attachment 1.

Unless otherwise provided, all new counterparties are subject to the Credit Approval Process prior to entering into any Transactions. Once approved by the RMC, a counterparty's authorized credit limit may be increased at no higher limit than as delegated in this Policy.

The RMC shall review the list of Approved Counterparties on an annual basis, or as needed.

4. Credit Approval

Power Resources is responsible for recommending new counterparties for credit review and approval. Credit limits shall be established for credit worthy counterparties based upon satisfactory review of two years of audited financial statements including, but not limited to, the balance sheet, income statement, statement of cash flows and associated notes. All counterparties will be reviewed for public debt ratings as published by Nationally Recognized Statistical Rating Organizations ("NRSRO") such as Standard & Poor's Rating Group (S&P) and Moody's Investor Services (Moody's). The counterparty must possess a long-term, senior unsecured debt rating as described in Attachment 2. Exceptions to these standards are described in Attachment 2.

Long-term Transactions proposed between RPU and counterparties not meeting the above criteria are subject to the prior approval of the Public Utilities Board and the City Council.

Once a counterparty has been determined creditworthy, a credit limit will be proposed by the Middle-Office pursuant to the methodology provided in Attachment 3.

Although a counterparty may qualify for a certain maximum credit limit, anticipated Transaction volumes, proprietary scoring, default probabilities as provided by a reputable credit monitoring service, and other business factors may prompt the selection of a lower limit that is considered more appropriate. As a result, the credit limit methodology provides limit ceilings while allowing flexibility in response to normal business activities.

5. Credit Enhancements

Wholesale counterparties that do not meet the minimum requirements for an extension of an open line of credit shall post at least one of the following types of security prior to the execution of Transactions:

a. Guarantees:

Wholesale counterparties may provide a Guarantee from a third party, or parties, that meet the creditworthiness requirements. If a counterparty provides such a Guarantee, the amount of any open line of credit will be determined through an analysis of the financial strength of the guarantor. The guarantor will be considered secondarily liable for the obligations of the counterparty.

All Guarantees must be approved as to form by the City Attorney's Office. Specific policy requirements for Guarantees are described in Section 5 of the Authorized Transactions Policy.

b. Letter of Credit:

Counterparties may provide an irrevocable Letter of Credit for an amount sufficient to cover the related Transactions. Letters of Credit must be issued by a bank or a financial institution which has a senior debt rating of at least "A-" (or its equivalent) from a NRSRO. Letters of Credit must have a term of at least forty-five (45) days past the term of the Transaction(s).

c. Prepayment:

For sale Transactions, counterparties may provide a prepayment or a cash margin deposit in an amount that is sufficient to cover the related Transactions. Discounts for prepayment, consistent with industry standards, may be applied to the sum owed as authorized by the Utilities Assistant General Manager-Finance and the Public Utilities General Manager.

6. Credit Controls

Controls over counterparty inputs and systems operations are of particular importance in ensuring the integrity of data used in counterparty credit risk control and management. In all cases, the Energy Risk Manager, or their designee, will be responsible for managing the wholesale counterparty review and ratings process, monitoring credit risk and wholesale counterparty reporting pursuant to Section 4 of the Energy Risk Management Policy.

The Energy Risk Manager shall notify Utilities Power Resources Managers and RMC in the event that the counterparty is determined to be an unacceptable credit risk. The Energy Risk Manager may reduce the counterparty credit limit as a result of a credit event as described in Attachment 4 of this Policy. Intentionally entering into unsecured Transactions with a wholesale counterparty that has total credit exposure in excess of its credit limit is not allowed under this Policy unless otherwise approved. Power Resources' delegated authority to Transact with approved counterparties is discussed in Section 4 of the Energy Risk Management Policy.

RPU's Power Scheduler/Traders and/or other Public Utilities employees or officers responsible for Transacting Activities shall not be involved in the counterparty underwriting process. The underwriting process shall have complete independence from all Transacting Activities and Power Resources staff.

7. Margin Calls

A margin call may be necessary when counterparty credit exposure exceeds an established credit limit. Timing of a margin call is not dictated by this Policy, but factors to consider include financial capacity, volume of business, overall portfolio concentration and market conditions. Calling margin may include a request for cash collateral or other credit enhancement. The Energy Risk Manager and Utilities Assistant General Manager-Finance are responsible for implementing a margin call.

8. Reserves for Wholesale Exposure and Credit Losses

The Utilities Assistant General Manager-Finance and the RMC are responsible for ensuring adequate reserves for wholesale credit exposure and credit losses pursuant to RPU's reserve policies.

9. Credit File Documentation

Credit analysis, approvals and denials must be documented in writing and all counterparty information shall be contained in formal credit files that are maintained by the Energy Risk Manager or their designee. These credit files are expected to contain audited financial statements and a credit review analysis report. These files should also contain as much of the following as possible:

- i. At least the two most recent years of audited financial statement information.

- ii. Rating information as published by a NRSRO.
- iii. Other market intelligence or relevant information related to the counterparty.
- iv. General industry information.

10. Waivers

Many of RPU's potential counterparties may be counterparties identified as small-scale power producers, limited liability entities, or special purpose entities, or there may be extenuating circumstances whereby a waiver of the standards in Section 4 is necessary to avoid anticipated regulatory penalties. Unless specifically exempted as described in Attachment 2, the Energy Risk Manager may waive the standards in Section 4 for term Transaction with such entities.

11. Policy Review

Prudence is required in implementing any and all policies and procedures. Market and industry norms, technology and risk tolerances tend to change over time. Therefore, this Policy shall be reviewed annually or as necessary, in order to make adjustments in response to changes in business objectives and/or industry norms. All substantive amendments are to be reviewed by the RMC and presented to the Public Utilities Board and City Council for final approval pursuant to Section 3 of the Energy Risk Management Policy.

12. Associated Guidelines, Controls, Policies and Procedures

The required supporting policies and procedures to this Policy are outlined below. Approval and modification of such supporting policies and procedures requires the approval of the Public Utilities Board and City Council, unless otherwise stated.

City of Riverside Public Utilities Energy Risk Management Policy

City of Riverside Public Utilities Authorized Transactions Policy

City Council Resolution Approving Current Policies and Procedures

ATTACHMENT 1

Authority to Establish Counterparty Credit Limits

Energy Risk Manager	Up to \$ 5,000,000
Assistant General Manager-Finance	Up to \$10,000,000
Assistant General Manager-Resources	Up to \$10,000,000
Public Utilities General Manager	Up to \$15,000,000
Risk Management Committee	Up to \$20,000,000
Public Utilities Board/City Council	Up to \$20,000,000+

The maximum amount of any open line of credit to be extended to any wholesale customer or counterparty¹ shall not exceed \$15,000,000, unless authorized by the RMC. This maximum assumes the largest loss contingency acceptable to RPU given current capital constraints. If credit lines exceeding \$20,000,000 are anticipated, review by the Public Utilities Board and approval by the City Council is required.

¹ For the purposes of this Policy, the CAISO is not considered a counterparty that is subject to credit limits.

ATTACHMENT 2

Credit Approval Exceptions

The counterparty must possess a long-term, senior unsecured debt rating of AT LEAST BBB- (or its equivalent) from an acceptable NRSRO. Counterparties with a rating of less than BBB- will be considered on a case-by-case basis. If ratings differ between NRSROs, the lowest available rating will be used for underwriting purposes. If the counterparty does not have a NRSRO rating, RPU Middle-Office shall establish and assign an internal rating.

Counterparties that do not possess at least a BBB- rating and satisfactory financials are generally not acceptable credit risks. However, the following counterparties are not subject to this credit review criteria:

- a. Any counterparty and/or resource in which RPU has an interest through a legally separate financing agency (e.g., Southern California Public Power Authority, Intermountain Power Agency, etc.).
- b. California municipal organizations with a rating of A- or better. Such counterparties shall be automatically added as an Approved Counterparty with a maximum credit limit of \$3 million.
- c. Counterparties associated with day-ahead/hour-ahead purchases where risk associated with market movements is eliminated.
 - i. Sale Transactions can be consummated if the counterparty maintains at least a BBB- rating from an NRSRO. Such Transactions may not exceed \$250,000 in aggregate net receivable per counterparty determined by using the most recent information available distributed by the Middle-Office.
 - ii. If a counterparty does not maintain any NRSRO ratings, a policy limit of \$100,000 in aggregate net receivables, per counterparty, is authorized until a formal review can be completed.
- d. Counterparties providing electric capacity products as discussed in Attachment 2 of the Authorized Transactions Policy.
- e. Counterparties subject to a master agreement for transactions whereby the credit risk is not assumed by RPU (e.g. Intercontinental Exchange or the CAISO).

ATTACHMENT 3

Counterparty Credit Limits and Credit Exposure

Counterparty Credit Limits

For publicly traded/privately held entities, an open line of credit may be extended up to 5% of the counterparty's adjusted tangible net worth, not to exceed \$15,000,000

Tangible Net Worth is defined as the sum of:

Shareholder equity; **minus**,
Goodwill; **minus**,
Intangible assets.

Dependent upon factors such as the size or terms of the Transaction, the following shall be included, in addition to the above, in the determination of Tangible Net Worth **minus**:

Receivables from officers;
Investments in other trading companies;
Off-balance sheet liabilities.

In the case of municipal organization counterparties, an open line of credit may be extended up to 25% of average Free Cash Flow for the prior two years, not to exceed \$15,000,000.

Free Cash Flow is defined as the sum of:

Net income; **plus or minus**,
Non-cash charges such as depreciation; **plus or minus**,
Changes in accounts receivable, inventory, prepaid expenses, accounts payable, and accrued liabilities; **minus**,
Principal Debt Service payments;
And any other adjustments deemed appropriate by RPU.

Credit Limit is defined as:

The open line of credit approved by the RMC supported with, if necessary,
The approved amount of any Guarantee(s) held,
The value of any letter of credit or cash collateral held, and/or
The approved value of any other type of collateral held.

Should a counterparty not have the components described above, the determination shall be based on other factors such as NRSRO ratings, financial statements, default probability scores, etc., on a case-by-case basis by the Energy Risk Manager.

Open lines of credit are to be established according to the limits and guidelines for approval noted below:

<u>RPU/NRSRO Rating Scale</u>	<u>Limit as % of Policy Maximum</u>
AAA	<=90 - 100%
AA	<=80 - 89%
A	<=70 - 79%
BBB	<=60 - 69%
BBB-	<=59%

For example, if a municipal counterparty qualifies for a credit limit of \$10,000,000 based on the cash flow test (e.g., 25% of average free cash flow for past two years not to exceed \$15MM), but only has a rating of BBB, then the maximum policy limit allowed would be \$6,900,000 (\$10MM x .69 = \$6.90MM).

Credit Exposure

The total amount of a counterparty's credit exposure is defined as the sum of:

- The dollar value of all amounts invoiced and unpaid (accounts receivable); plus
- The dollar amount of all deliveries that have not yet been invoiced (unbilled sales); plus
- The positive marked-to-market value of all forward trades; less
- All offsetting amounts that are supported by legally binding netting agreements.

ATTACHMENT 4

Credit Events

Upon one or more of the following events, the counterparty's approved credit limit may be reduced to not to exceed \$100,000 unless authorized by the RMC:

- i. Rating drops below BBB- from an acceptable NRSRO.
- ii. Default Probability greater than a one-year BBB- equivalent default percentage published by an acceptable NRSRO or from a subscribed credit rating service.
- iii. Proprietary Scores such as "FRISK2" indicating high default/bankruptcy probability.
- iv. Other events requiring counterparty credit review may include, but are not limited to, press announcements, mergers, acquisitions, business sale, company reorganization, and name changes.

ATTACHMENT 5

Riverside Public Utilities Internal Assessment of Risk Management Controls For the California Wholesale Electric Markets

The purpose of this document is to describe Riverside Public Utilities' ("RPU") internal assessment of the various risks that RPU is exposed to in its participation in the organized wholesale electric market and its Congestion Revenue Rights ("CRR") allocation and auction activities within the California Independent System Operator Corporation ("CAISO") and the current governing risk management policies, procedures and controls applicable in managing these risks.

RPU is a Scheduling Coordinator ("SC") in the wholesale electricity market operated by the CAISO. Under the CAISO Tariff, RPU is required to sell its power resources imported into the CAISO balancing authority and its local electric generation into the CAISO energy or ancillary services markets. Also, RPU is required to purchase the energy and the associated ancillary services needed for RPU's load from the CAISO energy and ancillary services markets. RPU is a CRR Holder in the CAISO markets enabling RPU to participate in the CAISO CRR allocation and auction processes for the purpose of hedging the risk of congestion costs for delivery of the energy required to meet RPU's load. Further, RPU purchases transmission from the CAISO for RPU's purchases and sales of energy and ancillary services within the CAISO balancing authority. In addition, RPU is a Participating Transmission Owner in the CAISO and receives payments from the CAISO for the use of RPU's transmission Entitlements.

To help manage RPU's exposures and risks, the City Council has approved the Power Resources Risk Management Policies governing the types of transactions and delegations of authority deemed appropriate. The volumes of forward transactions for RPU's short and long positions require RPU Risk Management Committee approvals. RPU is exposed to various risks through its participation in the CAISO Markets. These risks may include, but are not limited to, legal risk, credit/default risk, liquidity risk, market risk, concentration risk, operation risk, business risk and risk of loss of financial security amounts held and invested by the CAISO. RPU recognizes and manages the identified risks as follows:

Legal Risk

The principal legal risks associated with RPU's participation in the CAISO's markets arise from potential changes in the CAISO's Tariff either at the request of the CAISO or at the direction of the Federal Energy Regulatory Commission ("FERC") that could have a significant impact on RPU's delivered costs for energy, capacity requirements and associated costs, operational policies, and/or administrative burdens and costs. RPU manages these risks by monitoring all ISO stakeholder processes and filings with FERC and participating actively in stakeholder and subsequent FERC processes relating to issues that may have a significant impact on RPU's costs or operations. In addition, RPU monitors regulatory policy developments at FERC and participates in FERC proceedings relating to issues that may have a significant impact on RPU.

There are also legal risks associated with RPU's identification and correction of errors in billings by the CAISO. RPU manages these risks by reviewing settlements statements from the CAISO and initiating dispute resolution procedures under the CAISO Tariff when errors are identified.

Credit/Default Risk

RPU defines credit risk as exposure to potential loss from the failure of a counterparty to honor its obligations, including the obligation to settle on a timely basis. In RPU's Power Resources Risk Management Policies-Wholesale Counterparty Risk Management Policy, the CAISO is not considered a counterparty that is subject to credit limits. Similarly, default risk is defined as the exposure to loss resulting from the counterparty's failure to pay or perform on a contract.

The CAISO is a not-for-profit, operator charged with managing the flow of electricity within the CAISO balancing authority via centralized energy, ancillary services and transmission congestion management markets. These markets are used to allocate transmission use, maintain operating reserves and match supply with demand at all times in the most economic manner. The CAISO does not maintain operations that would be considered "stand alone" under a normal credit review. RPU must transact with the CAISO in its role as an SC in the CAISO markets that serves retail load which depends on CAISO transmission services and is exposed to counterparty credit risk as a result. Because this atypical counterparty credit risk is a business risk inherent in the CAISO markets, RPU has been a strong supporter of CAISO initiatives that enhance the CAISO's credit and counterparty risk assessment practices to reduce the overall credit/default exposures to the Market Participants participating in the CAISO markets. Examples of RPU involvement in this respect are its support for (a) the current CAISO policy of allocating defaults in the CAISO markets to all CAISO market participants as opposed to the previous CAISO policy of allocating such defaults only to net creditors in the CAISO markets (usually RPU is a net creditor in the CAISO markets); (b) CAISO policy of unsecured credit limit of \$50 million for SC and its affiliates in aggregate in the CAISO markets. RPU has and will continue to be actively engaged in CAISO initiatives that will further enhance CAISO policies on credit/default management.

Liquidity Risk

As it relates to the CAISO, liquidity risk is the risk that arises as a result of the CAISO being unable to meet short term financial demands. Through the Credit Reforms in Organized Wholesale Electric Markets, the CAISO is setting standards and practices to reduce its liquidity risk. Specifically, (1) CAISO shortened the invoicing and payment cycle from the previous biweekly cycle to weekly cycles; (2) Market Participants are required to post financial security with the CAISO above their unsecured credit limits (\$50 million per SC and their affiliates in aggregate) and certify that they will maintain sufficient liquidity to pay CAISO invoices; (3) CAISO eliminated the use of unsecured credit for participation in the CRR auction process; and (4) eliminated the use of unsecured credit for the ongoing financial liabilities related to holding CRRs. As a Market Participant, RPU is subject to the CAISO Tariff and the Business Practice Manual for Credit Management ("BPM"). RPU has participated and will continue to participate in the Stakeholder processes that enhance CAISO credit policies on credit/default management.

As it relates to the utility, RPU maintains ample cash and strong liquidity. The City Council approved a Regulatory Risk Reserve Account, an Energy Risk Management Reserve Account, and an Operating Reserve Account, all of which are considered internally restricted assets. These funds are available for current operations, or other strategic purposes upon approval of the Board and City Council. RPU plans to continue to build its cash reserve.

Market Risk

As an SC in the CAISO markets that serves retail loads, RPU is exposed to market risks in the CAISO markets in the form of energy and ancillary services market clearing prices for sales and purchases RPU makes in those markets. RPU is also exposed to transmission congestion risks revealed through the congestion prices embedded in the market clearing prices for energy and through charges for backstop procurement of capacity by the CAISO for reliability purposes. In

addition, RPU is exposed to the perverse consequences of manipulative practices by market participants exploring the weaknesses of CAISO Tariff, rules and protocols to the detriment of the CAISO markets in general, e.g., in the past, some market participants explored the mismatch between CAISO scheduling and settlement timelines for HASP and real time markets by submitting matching virtual convergence bids to extract tens of millions of dollars from load serving entities; also in the past, some market participants explored the weaknesses in the formulation of bid cost recovery mechanism by submitting deceptive generation schedules to again extract tens of millions of dollars from load serving entities without any benefit to the CAISO markets.

With the complexity of existing markets, and implementation of new market initiatives and products, participants must rely on the CAISO Department of Market Monitoring and the CAISO Market Surveillance Committee to analyze market performance and activity, identify potential market manipulation and aggressively pursue anti-competitive behavior. Although there have been some high profile successes, it is not possible to ascertain the extent to which this may occur, and any significant negative impacts to market participants, and mitigate such negative impacts.

Pursuant to RPU's Power Resources Risk Management Policies, RPU has and is continuing to actively manage these market risks by (a) procuring sufficient resources at known costs to meet RPU's anticipated load ahead of time to reduce/eliminate energy price exposures; (b) certifying, when technically feasible, RPU's local generating units to provide ancillary services, thus reducing/hedging the cost of ancillary services purchased in the CAISO ancillary service market; (c) actively participating in the CAISO CRR allocation and auction processes to obtain sufficient CRRs to hedge the transmission congestion costs associated with RPU's power resources; (d) procuring sufficient resources at known costs to meet RPU's capacity requirements, thus reducing/eliminating potential financial exposures to CAISO backstop capacity procurement costs; (e) participating proactively in the CAISO stakeholder initiatives to institute market designs/monitoring and rules of conduct conducive to a well-functioning market and eliminate deceptive and manipulative conducts that are detrimental to the market.

Furthermore, RPU has established processes and valuation methodology to specifically value the transmission congestion risks associated with its power resources and the use of CRR instruments to hedge such risks. The description of the valuation methodology is in Appendix A. RPU intends to perform such valuation and assessment on a periodic basis but no less frequent than annually.

Concentration Risk

As explained above, RPU's concentration exposure to the CAISO markets is atypical in that RPU must sell into the CAISO markets, all of its imports into the CAISO balancing authority and its local generation and RPU must buy from the CAISO markets all energy and ancillary services needed to serve RPU's retail load. RPU is also 100% dependent upon CAISO for transmission services. Thus, RPU's concentration exposure to the CAISO markets on a gross basis is 100% for sales and purchases of energy/ancillary services as well as transmission services. The CAISO current practice is to net the sales against the purchases for financial settlement and credit risk management purposes. Given this practice, the tools used by RPU to mitigate this atypical concentration risk are those described in the Market Risk section.

Operation Risk

The CAISO's operating and market rules and protocols are complex and constantly evolving and thus expose RPU to the following types of operation risks: (a) inability to respond to CAISO operating/dispatching directives due to imperfect modeling of RPU's local generation capabilities; (b) conflicting operating directives or absence of operating directives when needed; (c) CAISO operating/dispatching directives for the benefit of the CAISO that might conflict with RPU's

distribution reliability needs; (d) imperfections in CAISO software and hardware that could cause lost market opportunities or additional costs; (e) potential inability of RPU to timely upgrade the RPU software systems to conform with CAISO software system requirements causing loss in efficiency, lost market opportunities and resulting in additional costs.

RPU has managed and will continue to manage these operational risks by (a) maintaining close communication and coordination with the CAISO operations personnel when operational issues arise; (b) seeking to clarify operational issues ahead of time via formal agreement, e.g., MSS agreement; (c) participating in the CAISO stakeholder initiatives to institute clear market/operational rules and protocols to reduce/eliminate potential conflicts in the first instance.

Business Risk

As stated above, the CAISO is the single largest wholesale transaction counterparty that RPU is required to conduct business with and in doing so exposes RPU to a variety of business risks described above, e.g., legal, credit/default, liquidity, market, concentration, and operation risks.

The specific strategies to mitigate such business risks are as described above.

Loss of Financial Security Amounts Held and Invested by the CAISO

As stated above, RPU must transact with the CAISO in the energy and ancillary service markets for its imports and local generation, relies on the CAISO for transmission, and participates in the CAISO CRR allocation and auction processes. Thus, it is certain that RPU will need to post secured credit postings with CAISO for certain transactions, e.g., CRR auctions and possibly for other transactions, e.g., energy transactions if CAISO institutes credit policy based on gross purchases. As required by the CAISO Tariff and the BPM, RPU is required to post financial security held in an account managed by a designated financial institution for the benefit of the CAISO. Although, these policies have the potential to increase the costs to RPU in the CAISO markets, such policies are beneficial mitigating factors in reducing the risk of loss of financial security amounts posted by RPU. RPU has accepted this atypical risk of Loss of Financial Security as a business risk inherent in RPU's compulsory participation in the CAISO markets and will continue to proactively monitor and participate in the related CAISO stakeholder initiatives.

Minimum Participation Verification Process Congestion Revenue Rights

The following is a description of RPU's process used to value the risks of holding Congestion Revenue Rights (CRRs) in the CAISO market and methods used to minimize such risks, as stipulated in FERC Order 741, Sections 3.a.i, 3.a.ii, and 3.a.iii.

Section 3.a.i

Describe the valuation and risk assessment methodologies used.

RPU recognizes holding CRRs has inherent risks that must be managed. Such risks stem from holding negatively valued CRRs that the holder must make payment for. RPU adopts a conservative strategy to minimize such risks. This strategy is based on two principles: (1) RPU only acquires CRRs transmission paths with matched source-sink pair to physical resources that have ownership entitlement or contracts with at the source locations and load at the sink location, and (2) RPU attempts to avoid obtaining negatively valued CRRs holdings during the CRR allocation process and RPU strictly prohibits the acquisition of negatively valued CRRs in the auction process.

Methodologies to implement this strategy begins with an analysis of historical congestion charges on the transmission paths that RPU requires to wheel power from its resources to its load. RPU staff then develops a CRR nomination strategy that takes into account cost volatility and binding constraints for each path. The objective is to identify the paths having higher congestion cost volatility that are also more likely to be available for RPU to obtain via the free allocation process. Once these paths have been identified, the paths are prioritized for nominating CRRs in the CAISO allocation process.

RPU avoids nominating or purchasing CRRs on any path that exhibits clearly negative congestion patterns. By minimizing the nomination in the allocation process on paths that historically have congestion patterns in the opposite direction of RPU's resource-to-load pair and adopting a strict prohibition on acquiring negatively valued CRRs in the auction process, RPU substantially mitigates the possibility of holding negatively valued CRRs in its CRR portfolio. In the rare cases where negative congestion patterns do occur, these can only occur on paths where RPU is simultaneously scheduling physical resources. Thus RPU will be financially indifferent to such negative congestion, since the excess revenue we receive on our physical schedule will offset the negative CRR congestion payment.

Discuss the highest risks to your CRR trading strategy and the methods used to assess your CRR holdings and activities relevant to such risks.

RPU does not take on unnecessary CRR risks. RPU's strategy and practice as described above is to procure CRRs only on transmission paths from its resources to its load by time periods (on and off), and to match to the maximum extent feasible the CRRs to resource-load pairs at all hours that CRRs are available and to procure no more CRRs than are required to serve its load, thereby hedging against congestion price volatility on those transmission paths.

However, such strategy does not completely eliminate the risks of holding negatively valued CRRs. For example, if RPU's resource is unavailable either due to a planned or a forced outage or operational/contractual considerations (e.g. peaking resources) and the congestion pattern is in the opposite direction of RPU's CRR (negatively valued CRRs), then RPU's physically based hedging strategy will not be effective. Therefore, RPU also performs a thorough review and

quantification of the historical congestion charges for the relevant periods when RPU's resources are most likely to be unavailable and try to eliminate (to the maximum extent possible) the holding of negatively valued CRRs during such time periods.

Section 3.a.ii

Describe your processes ensuring the independence of your valuation and risk assessment functions.

RPU's CRR risk assessment functions are performed by the Power Resource's Front-Office group on an ongoing basis. A detailed valuation of all RPU CRR holdings is also performed annually by the Front-Office group. After this valuation is completed, the Middle-Office group reviews the results and provides an independent assessment of the valuation methodology and results.

Pursuant to the City of Riverside Public Utilities Power Resources Risk Management Policies, appropriate segregation of duties is to be established and maintained throughout the system of controls over financial risks. Duties are segregated between Front-Office, Middle-Office and Back-Office. The Middle-Office is comprised of those functions related to risk management and counterparty credit. Middle-Office activities are the primary responsibility of the Energy Risk Manager as delegated by the Risk Management Committee. The Energy Risk Manager is to be functionally and organizationally independent from all business activities. The role of the Energy Risk Management function is review and oversight and will not include daily Front-Office or Back-Office business activities.

Describe the processes that are in place to ensure risks are adequately reported throughout the organization.

The valuation and assessment process described above are shared with RPU's Risk Management Committee on at least an annual basis (or more frequently as applicable).

In addition, pursuant to the City of Riverside Public Utilities Power Resources Risk Management Policies, the Energy Risk Manager is responsible for ensuring the effectiveness of the control structure, risk measurement and monthly management reporting. This includes preparing, verifying and distribution all risk management reports and also includes measuring, assessing and reporting all inherent risk profiles.

Section 3.a.iii

Discuss the relevant methods used to limit exposure in the CRR markets.

The method used by RPU to limit exposure in the CRR markets is as follows:

As described above, RPU only acquires positively valued CRRs in the CAISO allocation process in quantity, time periods and on paths that match RPU's resources and system load.

Any CRR shortfalls are covered in the auction process by purchasing only positively valued CRRs that match in quantity, time periods, and on paths that match RPU's resource-load pair. For this, RPU staff develops bid curves for each path of interest based on statistical analysis of historical congestion costs. At no time are bid curves submitted that can result in the acquisition of excess CRRs.

Describe the sources of liquidity your firm has access to in order to minimize the risk of default at various levels of risk events (sections of publically available SEC filings may be referenced).

RPU currently holds substantial working capital to fund the ongoing operational cash-flow requirements. Included are reserves specifically established for operation and energy risk management that can be used for financial liquidity purposes.

Briefly describe how Delegation of Authority or other policy, procedures and controls is used to restrict traders in the types of transaction they may enter into and their corresponding trade limits.

RPU staff can only participate in the CAISO allocation and auction processes to acquire CRRs for RPU's load. RPU staff is not allowed to conduct bilateral trades to sell acquired CRRs. All of RPU's CRR procurement strategies, assessment of congestion cost risks and collateral limits are reviewed and approved by RPU's Power Resources Managers. The CRR procurement process itself is conducted under the supervision of a Power Resources Manager. To cover CRR purchases and liabilities, the CAISO requires RPU to post a collateral deposit into a Secured Collateral Account. The minimum amount for RPU is currently \$500,000 for the annual auction and \$100,000 for the monthly auction. RPU's Usable Secured Available Credit exceeds the minimum \$500,000 for the CAISO CRR auction process. This collateral deposit becomes a hard upper bound during the CRR Auction process (both annual and monthly), limiting RPU's purchases to a pre-determined maximum purchase amount.

APPENDIX A

Subject: RPU CRR Valuation Methodology

Author: Scott M. Lesch, Ph.D.
Planning & Analytics Manager, Resources Division, RPU

CRR Valuation Methodology (using historical CAISO LMP-MCC pricing information)

The CA-ISO publishes the hourly day-ahead (DAM) LMP price components (energy, losses and congestion) for every significant node in the ISO system; these historical hourly prices are available back to April 1, 2009.

RPU conducts all CRR valuation based on historical congestion data. We first identify the source (injection) point of our transmission path with the appropriate CA-ISO node and defined the sink point to be the MLAP_RVSD node. Next, we compute the monthly average heavy-load (HL) and light-load (LL) LMP-MCC congestion price differences between these source and sink nodes for the previous 36 months, which by definition quantifies the congestion costs for each path during the previous three (3) year time period. We then average these data by either monthly or quarterly time intervals, in order to derive average congestion costs for our source-sink paths that align with the CAISO allocation and auction processes.

For purposes of future CRR valuation, we assumed that historical congestion estimates follow a well-defined statistical distribution with the same average costs over future time periods. We then calculated the total monthly HL and LL CRR value for each source to sink path as $\text{CRR Value} = (\text{CRR MW obtained}) \times (\text{total HL or LL hours}) \times (\text{monthly average congestion estimate})$, along with the probability distribution associated with each estimate. These calculations are used to project our total future CRR portfolio value, as well as to assist in the development of CRR nomination strategies and bidding curves (for the annual and monthly allocation and auction processes).

CITY OF RIVERSIDE PUBLIC UTILITIES

POWER RESOURCES RISK MANAGEMENT POLICIES

AUTHORIZED TRANSACTIONS POLICY

1. Purpose
2. Execution Authority
3. Transaction Authority
4. Transaction Management
5. Contract Requirements
6. Credit Requirements
7. Speculation
8. New Products Approval Process
9. Regulatory/Legislative Requirements
10. Associated Guidelines, Controls, Policies and Procedures

Attachment 1 – Authorized Transactions

Attachment 2 - Regulatory/Legislative Transactions

CITY OF RIVERSIDE PUBLIC UTILITIES
AUTHORIZED TRANSACTIONS POLICY

1. Purpose

The purpose of the City of Riverside Public Utilities ("RPU") Authorized Transactions Policy is to define the types of authorized Transactions referenced in Attachment 1, Authorized Transactions, and the delegated authority to execute the Transactions.

2. Execution Authority

Delegations of authority to execute Transactions are described in Attachment 1-Authorized Transactions, unless defined otherwise by the Risk Management Committee ("RMC").

3. Transaction Authority

All Transaction Activities in physical and financial products will be governed by the associated Transaction limits presented in this Policy and the Policies identified in Section 10. Forward and futures contracts are to be limited to identified resource or Hedge needs, subject to available product size.

A violation of these control policies is a serious matter, particularly if it involves RPU's reputation and financial standing in the industry. If a Front-Office representative knowingly enters into an unauthorized Transaction or transacts with a counterparty that has a credit exposure in excess of its assigned credit limit, he/she may be subject to disciplinary action as determined by the Public Utilities General Manager in a manner consistent with the City of Riverside's Human Resources policies.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into federal law. The Dodd-Frank Act ("Act") was enacted to increase transparency, accountability and ensuring stability in the financial markets. The Commodity Futures Trading Commission ("CFTC") has enacted regulations to implement the Act that regulate how financial swap transactions should be cleared, how counterparties to the financial swap transactions should have risk policies in place before engaging in such financial swap transactions, how such transactions must be conducted through a mandatory clearing mechanism, and registration/recordkeeping/reporting requirements of such financial swap transactions. Some of existing and future RPU's power and gas Transactions are likely to fall under the CFTC regulations under the Act. Therefore, RPU shall be in full compliance with the CFTC regulations under the Act.

4. Transaction Management

Term Transactions are authorized subsequent to the development of a Forward Strategy Sheet approved by the RMC. No new Transaction(s), (whether on a Term, Day Ahead or Real-Time basis) are to be entered into with a counterparty if such Transaction(s) is expected to cause the counterparty to exceed their credit limit, or if that counterparty has already exceeded their credit limit, except as they may mitigate (offset) existing exposure, or if those Transactions have prior approval of the Energy Risk Manager, Utilities Assistant General Manager-Finance, Utilities

Assistant General Manager-Resources or Public Utilities General Manager, within authorized limits and in accordance with the associated Policies identified in Section 10.²

The Utilities Power Resources Manager shall be authorized to enter into Transactions subject to (i) compliance with their authorized Transaction limits specified in Attachments 3 and 4 of the Energy Risk Management Policy, and (ii) with prior review and approval of the Transaction strategy by the Utilities Assistant General Manager-Resources. The Utilities Power Resources Manager shall be responsible for determining the type and cost of any proposed term Transaction. The Energy Risk Manager shall verify that the counterparty to the Transaction is on the RMC approved list of counterparties. The terms and conditions of all written Confirmations shall be reviewed by the Front-Office function to ensure that any non-standard terms and conditions are properly submitted for review and approval by the office of the City Attorney, if necessary, prior to RPU becoming financially committed to the Transaction.

All Transactions must be committed over recorded phone lines, via electronic mail, or through a signed Confirmation from both parties. All Transactions shall be executed at the Department's offices or the designated off-site locations in accordance with City of Riverside's emergency recovery plan. All other off-premises Transactions are prohibited unless authorized by the Public Utilities General Manager and reported to the Risk Management Committee in specific instances.

Once the term Transaction has been completed and confirmed by the Counterparty, it is the responsibility of the Utilities Power Resources Manager to document the Transaction on a Deal Sheet and update the Power Resources systems and records to reflect all current Transactions. Signed copies of the Deal Sheet, the written Confirmation and other related documents shall be sent to the Energy Risk Manager within five (5) business days of the Transaction for verification that the deal was an approved Transaction pursuant to the approved Forward Strategy Sheet. Such documentation shall also be provided to the applicable Utilities Power Resources Managers within five (5) business days of the Transaction.

5. Contract Requirements

a. Master Agreements:

The use of master or enabling agreements to govern trading relationships with counterparties is considered to be the preferred practice and should be followed whenever reasonably possible. The Utilities Power Resources Managers have the delegated authority to execute individual written confirmations, cover sheets or other agreements made pursuant to an approved master agreement or enabling agreement. Below is a list of the agreements already approved or contemplated.

- i. The Western Systems Power Pool ("WSPP") Agreement, as amended, should be used as the master agreement for short-term physical and financial Transactions with WSPP members. The WSPP Agreement applies to all Transactions between WSPP members, unless the parties to a Transaction expressly opt out of the WSPP Agreement. Individual members can specify on the WSPP website whether it agrees to the netting provisions in the agreement. The WSPP Agreement was approved by City Council on November 9, 1999.
 - Master confirmation agreements should be used to confirm all Transactions entered into under the WSPP Agreement of one week or more, or for which the counterparty sends a confirmation agreement containing terms that do not conform to the Master Agreement or if desired by RPU or the counterparty.

² The prohibition against entering into Transactions which result in a counterparty exceeding or continuing to exceed their established credit limit presupposes that Front-Office personnel have been provided with all relevant accounts receivable and payment information related to the counterparty.)

- ii. North American Energy Standards Board Contract for Sale and Purchase of Natural Gas ("NAESB") is a standardized set of business practices and standards that most buyers and sellers have adopted for their natural gas and electricity physical Transactions. The NAESB does not require any specific purchase or sale of natural gas, but constitutes the terms and conditions that would apply to any natural gas or electricity purchase or sale ultimately agreed to between RPU and a counterparty who subscribes to the NAESB contract terms and conditions. The NAESB was approved by City Council on April 8, 2008.
 - Transacting under the NAESB with an approved counterparty will require an executed Base Contract for Sale and Purchase of Natural Gas which incorporates by reference the general terms and conditions as published by the NAESB, and specifying certain elections and special conditions applicable to individual Transactions.
- iii. The Edison Electric Institute ("EEI") Agreement may be used as the master agreement for financially firm power product Transactions in lieu of the WSPP Agreement, and for Transactions with non-WSPP members. The EEI Agreement provides an array of reciprocal credit and collateral requirements for each party and counterparty to be negotiated and specified on a "Cover Sheet." The EEI Agreement was approved by City Council on October 11, 2011.
- iv. International Swaps and Derivatives Association, Inc. ("ISDA") agreements should be used for all Swap Transactions and may be used in lieu of the EEI Agreement for financially firm power products. The ISDA multilateral procedure saves time and expense that would otherwise be spent on bilateral negotiations. Special provisions or elections shall be negotiated and specified on a "Cover Sheet." This agreement has not yet been approved by the City Council.

Master netting agreements should be incorporated into all counterparty agreements and Transactions.

b. Terms and Conditions:

Terms and conditions shall not conflict with the terms and conditions required by the City of Riverside as described below. All master or enabling agreements must be approved as to form by the City Attorney's Office and the City Council prior to execution. All confirmations or special conditions that substantively modify the legal terms and conditions in the related master or enabling agreement must be reviewed and approved as to form by the City Attorney's Office and then approved by the Utilities Power Resources Management.

Absent prior authorization from the appropriate regulatory body(ies), any agreement entered into pursuant to this Policy ("Agreement") containing terms and conditions inconsistent with those articulated below will not be a valid agreement.

- i. Each counterparty to any Agreement must warrant and represent that it possesses the necessary corporate, governmental, and/or legal authority, right, and power to enter into the agreement and perform each and every duty imposed thereunder.
- ii. No provision of any Agreement shall restrict the ability of the City to enter into new agreements with any counterparty or to perform fully under any existing agreement.

- iii. Unless specifically required by a master or enabling agreement duly approved by the appropriate regulatory body(ies), no provision of any Agreement shall require the City to unilaterally indemnify or release from liability any counterparty, nor shall it impose indemnification or release of liability obligations on the City less favorable than those imposed on the counterparty(ies) to the agreement.
- iv. No waiver by the City of its rights under an Agreement shall be deemed a waiver with respect to any other rights under that agreement or any other agreement.
- v. Nothing contained in any Agreement shall be construed to create an association, joint venture, trust, partnership, or agency relationship between or among the parties, or to impose a trust or partnership covenant, obligation, or liability on or with regard to any of the parties.
- vi. No Agreement shall be construed to create rights in, or to grant remedies to, any third party as a beneficiary of that agreement or of any duty, obligation, or undertaking established therein.
- vii. If the City has reasonable grounds for insecurity regarding the performance of any obligation under any Agreement by any counterparty and the Agreement so provides, the City may demand adequate assurance of performance, including, but not limited to, a standby irrevocable letter of credit, a prepayment, a security interest in an asset, or a performance bond or guaranty.
- viii. No provision in any Agreement shall restrict the ability of the City to seek specific performance of any counterparty's duties and obligations under that Agreement in any court of competent jurisdiction.
- ix. No Agreement shall obligate the City to submit any dispute arising therefrom to binding arbitration.
- x. No provision in any Agreement shall require the City to act in contravention of the California Public Records Act or otherwise restrict the ability of the City to comply with existing, applicable laws and regulations.

c. Special terms and conditions related to Guarantees

Any guaranty entered into for the purpose of protecting the financial interests of the City shall contain the following provisions:

- i. A statement that the guaranty is one of payment and not of collection.
- ii. A statement that the guaranteed obligations are unconditional, irrespective of value, genuineness, validity, waiver, release, alteration, amendment, or enforceability of the guaranteed obligations.
- iii. A statement that the guarantor agrees to pay the guaranteed obligations on the date due and waives demand, notice, marshaling of assets, or any comparable requirements.
- iv. A statement that the guarantor waives its right to subrogation until the guaranteed obligations are paid in full.

- v. A statement that the guaranty shall reinstate if any guaranteed obligation made by the primary obligor is recaptured as a result of the primary obligor's bankruptcy or insolvency.
- vi. A statement that the guaranty is binding on successors of the guarantor.
- vii. A statement restricting the guarantor's right to terminate the guaranty with less than thirty (30) days notice.

6. Credit Requirements

Credit requirements and limits are identified in the Wholesale Counterparty Risk Management Policy.

7. Speculation

Speculative trading activities and positions are prohibited. Hedging and portfolio Optimization is permitted.

8. New Products Approval Process

A New Product is any physical or financial instrument, transaction type or commodity market currently not defined in the most recently approved Authorized Transactions.

The RMC is delegated authority to approve New Products. In a periodic report to the Public Utilities Board, the Public Utilities General Manager shall include an update and description of the New Products approved by the RMC.

The Utilities Power Resources Managers, the Assistant General Manager-Resources and the Assistant General Manager-Finance shall review the Transaction details, including but not limited to:

- i. Identification of risks and risks being mitigated.
- ii. Pricing and associated Premiums/discounts.
- iii. Credit and market exposure.
- iv. Operational elements.
- v. Internal operating considerations, administration and management, subject to Middle- and Back-Office verification.
- vi. Proposed reporting requirements, including any changes to current procedures and systems requirements arising from implementation.
- vii. Special consideration shall be given to the transaction process to ensure that proper control mechanisms are in place in order to prevent an unauthorized Transaction from being executed.
- viii. Accounting, regulatory, and tax related risk elements.
- ix. Legal, tax, finance and internal audit review and concurrence, if necessary.

Upon approval of the Assistant General Manager-Resources and the Assistant General Manager-Finance, the Utilities Power Resources Managers shall notify the Energy Risk Manager of their desire to enter into a new type of Transaction.

The Utilities Power Resources Manager shall prepare a report including the elements described above, the proposed limits, and written recommendation for RMC approval of the New Product and amendment to Attachment 1 of this Policy.

The report and written recommendation shall be presented to the RMC for review and approval. In the event that circumstances and/or market conditions do not allow for delay, the report and recommendation for approval shall be distributed in electronic format to the RMC. Transactions under the new product are prohibited until approved by the RMC.

9. Regulatory/Legislative Requirements

Regulatory requirements may result from either legislation being passed or regulations being implemented. RPU may be required to satisfy such requirements in a timely manner and failure to do so could subject RPU to severe penalties from a regulatory agency such as the CAISO or a reliability organization. Such requirements shall be fully described in Attachment 2-Regulatory/Legislative Transactions of this Policy and subject to RMC approval. Thereafter, individual Transactions shall not require prior approval but will be subject to after-the-fact reviews by the RMC at the next regularly scheduled RMC meeting.

10. Associated Guidelines, Controls, Policies and Procedures

The required supporting policies and procedures to this Policy are outlined below. Approval and modification of such supporting policies and procedures requires the approval of the Public Utilities Board and City Council unless otherwise stated.

City of Riverside Public Utilities Energy Risk Management Policy

City of Riverside Public Utilities Wholesale Counterparty Risk Management Policy

City Council Resolution Approving Current Policies and Procedures

ATTACHMENT 1

City of Riverside Public Utilities Authorized Transactions

Required master or enabling agreements must be in effect prior to any Transactions. The conditions described in the Governance sections below will fulfill some of the requirements under the Act.

1. Forward Power Purchases

- i. Cover a Forecasted Supply Shortage
- ii. Bonneville Power Administration ("BPA") Returns
- iii. Economic Displacement Power Purchase of existing physical resources
- iv. System and/or Local Capacity for Resource Adequacy Requirements

Governance

Monthly forward volumes are approved by the RMC.
The Forward Strategy Sheet shall be documented for transactional strategies and related Transactions.

2. Forward Power Sales

- i. Imbalance Transaction
- ii. Sell Forecasted Surplus Energy
- iii. Sell Forecasted Surplus System Resource Adequacy Capacity

Governance

Monthly forward volumes are approved by the RMC.
The Forward Strategy Sheet shall be documented for transactional strategies and related Transactions.

3. Purchases/Sales Transaction in CAISO Market

- i. Energy
- ii. Capacity
- iii. Ancillary Services
- iv. Congestion
- v. Losses
- vi. Transmission
- vii. Inter SC Trades
- viii. Congestion Revenue Rights
- ix. Demand Response

Governance

Short term Transactions (hourly) authorized under the Conformed Fifth Replacement CAISO Tariff as of November 5, 2012, are within the delegated authority of Attachments 3 and 4 to the Energy Risk Management Policy. Future CAISO market functionality which produces a new transaction type (e.g., convergence bidding) in which RPU is not mandated to participate, must be approved by the RMC and will be added to this list of CAISO approved Transactions. Such approval must occur prior to RPU initiating and

participating in new products or functionality that may be subsequently added to the CAISO markets.

4. Congestion Revenue Rights (“CRR”)

Governance

Transactions (monthly, annually, long-term) are within the delegated authority of Attachments 3 and 4 to the Energy Risk Management Policy.

5. Purchases/Sales for Generation and Transmission Outages (Planned/Unplanned) or Emergency Conditions

- i. Imbalance Transaction
- ii. Outage Conditions
- iii. Changes in Base Assumption encompassed in the Forward Strategy Sheet
- iv. Loss of Generation
- v. Loss of Transmission
- vi. CAISO declared emergency at a guaranteed price

Governance

Short term Transactions (hourly-daily) are within the delegated authority of Attachments 3 and 4 to the Energy Risk Management Policy.

6. Bilateral Purchases/Sales of Ancillary Services outside the CAISO

- i. Imbalance Transaction
- ii. Spin/Non-spin
- iii. Regulation

Governance

Short term Transactions (hourly-daily) and term Transactions are within the delegated authority of Power Resources.

7. Hedging Costs with Purchased Physical Transactions

- i. Physical Call
- ii. Physical Put (buying a Put when long on energy)
- iii. Heat Rate Options

Governance

Monthly forward volumes are approved by the RMC.

8. Hedging Costs with Financial Instruments (requires ISDA)

- i. Financial Call
- ii. Financial Put (buying a Put when long on energy)
- iii. Financial Swap (fixed/index) for Gas/Power
- iv. Physical Swap (fixed/index) for Gas/Power
- v. Weather Derivatives
- vi. Gas Options, Futures

Governance

The Forward Strategy Sheet shall be documented for transactional strategies and related Transactions.

Refer to discussion of Derivatives in Section 9 of the associated Energy Risk Management Policy.

9. Energy/Capacity Layoff

- i. Optimization Transaction
- ii. Banking
- iii. Cash Outs
- iv. Net simultaneous delivery to different geographical locations

Governance

Short term Transactions (hourly-daily) and term Transactions are within the delegated authority of Attachments 3 and 4 to the Energy Risk Management Policy.

10. Physical Natural Gas Products Purchase/Sale (requires “NAESB”)

- i. Energy
- ii. Transportation
- iii. Storage
- iv. Puts/Calls
- v. Balancing

Governance

Monthly forward volumes are approved by the RMC. The Forward Strategy Sheet shall be documented for transactional strategies and related Transactions.

Risk Considerations: RPU should ensure that any gas purchased under firm contracts is for anticipated forecasted operation and intended to be consumed at delivery when economic.

11. Renewable Energy Credits (Purchase/Sale)

- i. Complies with regulatory requirements

Governance

Monthly forward volumes are approved by the RMC. The Forward Strategy Sheet shall be documented for transactional strategies and related Transactions.

12. Emission Credits Purchases/Sales (forward and after-the-fact)

- i. GHG Allowance
- ii. Reclaim Trading Credits
- iii. Requirements as may be established

Governance

Sales of volumes excess to amounts required by regulatory agencies is authorized.

ATTACHMENT 2

City of Riverside Public Utilities Regulatory/Legislative Transactions

1. Capacity Procurement

RPU must satisfy its capacity requirements pursuant to any policies adopted by the City Council, imposed by the CAISO, or adopted by relevant regulatory agencies and reliability organizations. Since the capacity requirements pursuant to such policies are well defined and the procurement of capacity to meet such capacity requirements must take into account the most updated RPU's resources information, the RMC after-the-fact review shall document:

- i. The capacity requirements pursuant to the applicable policies, and
- ii. Existing available RPU's resources to meet the requirement.
- iii. The additional capacity procured to meet the capacity requirements.

Counterparties accepted by the CAISO to provide electric capacity products in the CAISO markets to meet CAISO capacity requirement policies shall be considered acceptable counterparties by RPU for the purchase of such capacity products. The performance obligations and monetary sanctions applicable to CAISO electric capacity products are the responsibility of the seller of such electric capacity products as specified in Section 6 "Bidding and Scheduling Obligations" of the CAISO Business Practice Manual for Reliability Requirements and Article V – Resource Adequacy, Section 40.7 "Compliance" of the Conformed Fourth Replacement CAISO Tariff as of January 5, 2010. Thus failure to perform by the counterparty for electric capacity products in the CAISO markets will not increase RPU's financial liability to the CAISO or to the counterparty.

2. Cap and Trade Regulation

Under the regulations promulgated by the California Air Resources Board ("CARB"), RPU must comply with mandatory reporting requirements ("MRR") for the Greenhouse Gas ("GHG") emissions as well as meet direct compliance obligations of GHG emissions from RPU's power generating resources by obtaining sufficient GHG allowance instruments for each compliance period. One GHG allowance entitles the entity holding it to incur one ton of GHG emission. Failure to meet direct GHG compliance during any compliance period will result in stiff financial penalties imposed by CARB that are multiples of compliance obligations.

RPU has been allocated approximately one million free allowances per year for each year during the period of 2013-2020 which approximately equates to RPU's GHG emissions from RPU's power generating resources per year. In theory, RPU is fully hedged against its direct GHG compliance obligations associated with RPU's power generating resources. However, if RPU is required to sell RPU's freely allocated allowances into the CARB administered quarterly auctions, RPU is likely to face mismatches between the allowance volume sold into the auction and allowance volume bought out of the auction. Such volume mismatches cannot be effectively or completely eliminated simply by engaging in hedging activities in the secondary markets. The most effective and cost neutral strategy is to engage in simultaneous buys and sales transactions in the CARB quarterly auctions trying to match the buy and sale volumes at all times. To the extent RPU is able to match the buy and sale volumes in any given auction, then the financial exposures can be managed and minimized.

In addition, RPU might engage in additional hedging activities in the auctions or in the secondary market for GHG compliance obligations not covered by the freely allocated GHG allowances. The Public Utilities Board and City Council have authorized the staff to engage in such hedging

transactions. RMC will be periodically informed of RPU'S compliance status with the Cap and Trade program which may include but not be limited to:

- i. The amount of RPU's freely allocated allowances by vintage year.
- ii. The amount of RPU's freely allocated allowances successfully sold (by vintage year) in the CARB auctions.
- iii. The revenues derived from the sales of freely allocated allowances by each quarterly auction.
- iv. The amount of allowance bought in the quarterly auctions and in the secondary market.
- v. The costs incurred from the purchases of allowances by each quarter.
- vi. The cumulative direct compliance obligations for the compliance period.

CITY OF RIVERSIDE PUBLIC UTILITIES

POWER RESOURCES RISK MANAGEMENT POLICIES

GLOSSARY

Approved Counterparty: Entities authorized to transact with RPU as described in Sections 3 and 4 of the Wholesale Counterparty Risk Management Policy.

Business Risk: Quantifiable or identifiable risk relating to normal power supply operations and to activities that are a by-product of the normal power supply activities of RPU that relate to development and sales of products and services, including support activities. Resource optimization is a fundamental activity within normal power supply operations. Such risk is necessary to production and delivery of products and services of RPU and cannot be avoided without RPU's incurring substantial economic disadvantage, since avoidance would unduly limit business operations. For example, a market exposure to fluctuations in hourly energy prices is a business risk if it results from activities within real-time supply activities. Forecasted Transactions that expose RPU to market risk and are probable of occurring are also considered business risks.

Counterparty Credit Risk: Exposure to economic loss resulting from default by a party to a contract (e.g., a counterparty).

Deal Sheet: A form prepared by the Utilities Power Resources Manager which describes the details of an Authorized Transaction, as identified in the Forward Strategy Sheet approved by the RMC. Each Deal Sheet is prepared to document the Transaction.

Derivative: Any financial instrument, such as a futures contract, Swap or Option, which derives its value from the value of an underlying security or physical commodity.

Energy Risk Management: Is the application of financial risk management tools to financial and physical risks in energy markets (power and natural gas). Can include risks measured in either monetary and energy units.

Financial Exposure: For a fiscal year is defined as the sum of the monthly products of the open long or short energy positions in electricity and natural gas in that fiscal year, multiplied by the respective forward prices for those commodities.

Forward Strategy Sheet: Provides a guideline of Transaction possibilities (purchase, sell or no action) and reflects current outlook of various Option products in lieu of outright commodity purchases where feasible in order to maximize flexibility and efficiency. Represents RMC approval of certain Transaction parameters.

Hedging: Reducing risk. It includes activities that reduce risk or that convert one type of risk to another deemed more tolerable. As a routine Power Resources activity, RPU hedges against price risk. To qualify as Hedging, an activity should be expected to produce a measurable offset to risk relating to an asset, liability, committed Transaction, or probable forecasted Transaction. Such offset should be measured against changes in market values or cash flows (e.g., marked-to-market).

Mark-to-Market (“MTM”): Marking to market is the process of determining the current value of all Transactions used to close inherent portfolio open positions over a defined period. Marking the portfolio to market identifies how the portfolio and individual Transactions compare to market valuations at a given point in time.

Optimization: The process of utilizing strategies and/or instruments to optimize economic benefits associated with load/resource management. Optimization differs from trading in that the strategic rationale for a Transaction is the driver rather than the economic benefit alone. Trading functions are designed to form commodity positions with the intent of speculating on market arbitrage opportunities.

Optimization Strategy: Any approved business activity that on its own or in combination does not increase risk but reduces net power costs.

Option: A contract that gives the holder the right, but not the obligation, to purchase or sell the underlying commodity, which could be a futures contract, a Swap or the commodity itself.

Premium: The price of an Option.

Prompt Month: The month following the current operating month (e.g., June is the prompt month if the current operating month is May).

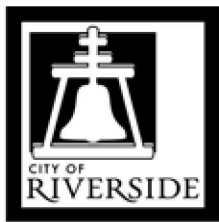
Risk Management: Limiting and reducing risk associated with all business activities of RPU that could result in economic loss. It includes activities that identify, measure, assess, limit and reduce risk. As related to the use of Derivatives, Risk Management means reducing risks in the broad sense of the term, including activities that select one type of risk over another when it is considered more tolerable, but it does not include activities that increase risk beyond levels established by this Policy.

Supply Requirements: Those requirements related to reliability and reserve standards mandated by (i) the Riverside City Council, (ii) the CAISO, and (iii) the requirements of regulatory agencies of competent jurisdiction.

Swap: A custom-tailored, individually negotiated Transaction designed to manage financial risk. In a typical commodity or price Swap, parties exchange payments based on changes in the price of a commodity or a market index while fixing the price they effectively pay for the physical commodity. The Transaction enables each party to manage exposure to commodity prices or index values. Settlements are made in cash.

Transaction: All of the approved Transaction types defined in Attachment 1 of the Authorized Transaction Policy. Includes physical or financial obligations of RPU and one or more counterparties related to energy, capacity, ancillary services, transmission service, natural gas, renewable energy credits and greenhouse gasses.

Transaction Activities: The activities involved in the energy supply decision process involving Transactions as defined herein.



City of Arts & Innovation

City Council Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL DATE: MARCH 5, 2013

FROM: PUBLIC UTILITIES DEPARTMENT ITEM NO: 13

WARDS: ALL

SUBJECT: PUBLIC UTILITIES POWER RESOURCES RISK MANAGEMENT POLICIES

ISSUE:

The item for City Council consideration is approval of the revised Power Resources Risk Management Policies which includes the Energy Risk Management Policy, the Wholesale Counterparty Risk Management Policy and the Authorized Transactions Policy.

RECOMMENDATION:

That the City Council approve the proposed revisions to the Public Utilities Power Resources Risk Management Policies, including the Energy Risk Management Policy, the Wholesale Counterparty Risk Management Policy and the Authorized Transactions Policy.

BOARD RECOMMENDATION:

On February 1, 2013, the Board of Public Utilities unanimously approved this item.

COMMITTEE RECOMMENDATION:

On February 14, 2013, the Utility Services/Land Use/Energy Development Committee, with Chair Gutierrez, Vice Chair Gardner and Member Davis present, unanimously approved and recommended that the City Council approve this item.

BACKGROUND:

Riverside Public Utilities ("RPU") procures the bulk of its power through long-term contracts. In order to predict how much power will be needed to serve customer load, the Power Resources Division prepares long-term forecasts. In general, the long-term procurements are over five years in length, provide a specified amount of annual power to RPU and are a mix of renewable and non-renewable resources.

However, RPU procures approximately 10-15% of its power, as well as the natural gas to power internal generation, from short-term contracts and individual purchases to cover planned and unplanned resource outages and additional summer peaking energy needs. These transactions are carried out by Power Resources staff, subject to the oversight of the City Council, the Board of

Public Utilities and the RPU Risk Management Committee. The oversight is set forth in the Public Utilities Power Resources Risk Management Policies (“RMP”).

In 1998, the first RMP document was approved. This policy was developed to give guidance to staff regarding the purchase and sale of energy related products in the newly deregulated energy market. The RMP prescribes delegations of authority, energy transaction parameters, maximum acceptable risk limits and procedures to manage wholesale counterparty credit risk. The policy is important in rating agency discussions and required for RPU’s participation in the California wholesale electric markets.

Practice and experience necessitates changes in the policy and contribute information to allow possible different decisions to be made in dealing with the risks being faced. The RMP has been reviewed on an annual basis and recommended changes were periodically adopted by the City. In 2010, the RMP was reformatted and revised to (i) streamline the original policy since it was designed as a comprehensive set of policies geared toward an organization with expansive trading and risk management activities, and (ii) reflect market changes as a result of 2009 California Independent System Operator Market Redesign and Technology Upgrade.

The components of the RMP include:

- Energy Risk Management Policy
- Wholesale Counterparty Risk Management Policy
- Authorized Transactions Policy

As part of the ongoing internal review process, the RMP has been updated largely in response to the changes in regulatory requirements and to better fit the needs and organizational structure of RPU. Strike-through and “clean” copies of the proposed policy are attached to this report. The following highlights the proposed changes:

Operational Management Oversight – Front-, Middle-, Back-Offices

The RMP defines roles by functional office, referencing them as Front-, Middle-, and Back-office. The Front-Office is comprised of those functions related to the business activities of RPU Power Resources, including planning, market operations and trading, and long term contracts. The Middle-Office is comprised of those functions related to risk management and counterparty credit, including the Energy Risk Manager. The Back-Office is comprised of those functions responsible for verification, validation accounting, processing, reconciling and settling all transactions.

The pre-existing responsibilities and delegations of authority have been reclassified by functional office rather than by manager title. Upon review of the energy risk management policies of similar municipal utilities, it was determined RPU was unique in its description of roles and responsibilities to specific managers in the Power Resources division. This design created both redundancy and inflexibility. Further, identifying and aligning the delegations of authority under Front-, Middle-, or Back-Office reduces organizational risk such as unclear lines of authority, inadequate staffing and lack of clear accountability over specific duties.

Revises Reporting Requirements

The current RMP includes a list of very specific and static reports for presentation to the Risk Management Committee (“RMC”) on a regular basis. The revised RMP allows for the development and presentation of reports at the pleasure of the RMC. This eliminates the burden on staff to create unnecessary reports in order to only meet a policy requirement thus allowing staff to focus on the development of more meaningful data.

Added Delegations of Authority

The following Delegations of Authority shall be added under the relevant function as described in the Energy Risk Management Policy:

The Utilities Assistant General Manager-Resources shall review and has the authority to approve the Transaction strategy.

RPU Administration has the authority to approve any non-substantive modifications or amendments to the RMP.

The Front-Office may enter into emissions Transactions to meet regulatory requirements.

The Middle-Office may have the authority to add new counterparties to the Approved Counterparty list with a credit limit not to exceed the approval authority as delegated in the RMP.

The Middle-Office is responsible for reporting the addition of new counterparties under the authority of the Energy Risk Manager and all credit limit changes with justification to the RMC.

Reformatting of the Wholesale Counterparty Risk Management Policy

The proposed RMP provides for moving hard coded methodologies into attachments rather than embedding them into the body of the policy. This will make the RMP more user friendly, transparent and will streamline future amendments.

Federal Energy Regulatory Commission Order 741

FERC Order 741 reforms and standardizes credit policies used in the organized wholesale electric power markets. Market participants must provide an annual attestation from an officer of the company that specific risk management principles are being followed by the company or responsible party. The proposed RMP includes an attachment to the Wholesale Counterparty Risk Management Policy for inclusion of RPU’s Internal Assessment of Risk Management Controls for the California Wholesale Electric Markets.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act was enacted to increase transparency, accountability and ensuring stability in the financial markets. The proposed RMP recognizes these new compliance requirements under the Authorized Transactions Policy.

Regulatory/Legislative Requirements

Regulatory requirements may result from either legislation being passed or regulations being implemented. The proposed RMP includes a new attachment to the Authorized Transaction Policy whereby these requirements shall be fully described for RMC approval. Thereafter, individual Transactions shall not require prior approval but will be subject to after-the-fact review by the RMC.

Amendment to the Authorized Transaction Policy

The following Transactions shall be authorized and added to Attachment 1:

Selling Forecasted Surplus System Resource Adequacy Capacity under Forward Power Sales.

Add (i) Green House Gas Allowances, (ii) Reclaim Trading Credits, and (iii) requirements as may be established under Emission Credits Purchases/Sales (forward and after-the-fact).

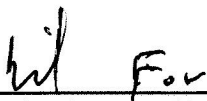
Overall, a major benefit of the delegations of authority described in the RMP is to provide a framework for the timely and orderly procurement of energy and fuel with adequate separation of duties and management oversight, while providing RPU the ability to react in order to preserve cost stability during periods when the markets are volatile. The proposed delegations are comparable to similar sized municipal utilities providing electric service in the State of California.

FISCAL IMPACT:

There is no fiscal impact associated with this report.

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Concurs with:



Ken Gutierrez, Chair
Utility Services/Land Use/Energy Development Committee

Attachments:

1. Power Resources Risk Management Policies - Red-line with accepted format changes
2. Power Resources Risk Management Policies - Clean
3. Board of Public Utilities Public Minutes of February 1, 2013